

CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY

**STAFF SUMMARY AND RECOMMENDATION
FRONT PORCH COMMUNITIES AND SERVICES**

Resolution Number 2005-15

September 29, 2005

BOND SALE DATES:	September 1997 & February 1999
ORIGINAL AMOUNTS:	Sunny View Lutheran Home, 1997: \$4,430,000 Sunny View Lutheran Home, 1999: \$5,685,000
OUTSTANDING AMOUNTS (as of 8/31/05):	Sunny View Lutheran Home, 1997: \$3,355,000 Sunny View Lutheran Home, 1999: \$4,975,000
RATING (Front Porch):	A (S&P, based on Cal-Mortgage insurance) BBB underlying rating (S&P)
CREDIT ENHANCEMENT:	Cal-Mortgage
TYPE OF FACILITIES:	Senior residences and continuing care facilities.
LOCATION:	Front Porch is headquartered in Burbank, with 13 facilities, mostly in southern California. Sunny View facilities are located in Cupertino.

ISSUE: Front Porch Communities and Services (“Front Porch”) is seeking Authority approval for assuming the obligations for Authority bond debt issued on behalf of its affiliate, Sunny View Lutheran Homes (“Sunny View”), in 1997 and 1999. Sunny View has been an affiliate since 2003. Following this transaction, Sunny View’s health care facilities, and their related bond debt, will be assets and liabilities of the Front Porch obligated group.

Front Porch will be executing an amended loan agreement with the Authority relating to each series of bonds in which they will agree to a gross revenue pledge and debt service coverage covenants. The obligation being assumed will be parity debt with Front Porch’s existing non-Authority bond debt.

POLICY ISSUE:

The Authority adopted bond issuance guidelines in September 2000 that include 1.25 times maximum annual debt service coverage tests as financial covenants. The Authority

acknowledged that each financing must be reviewed individually and exceptions to these guidelines may be considered. Front Porch's management has requested the use of debt service coverage ratios based on the most recent fiscal year rather than maximum annual debt service. This would then be identical to the tests applicable to Front Porch's existing non-Authority bond debt. Cal-Mortgage has indicated that this covenant would be acceptable. In consideration of this, and of the historical financial strength of Front Porch, staff recommends that the debt service coverage be based on the most recent fiscal year.

BACKGROUND: In 1997, the Authority issued bonds totaling \$4,430,000 on behalf of Sunny View to refinance non-Authority debt. In 1999, the Authority issued bonds totaling \$5,685,000 on behalf of Sunny View to finance the construction of a two-story assisted living facility and various remodeling projects. Front Porch and Sunny View signed an affiliation agreement, effective January 1, 2003, whereby Front Porch became the sole corporate member of Sunny View. Front Porch also agreed to a limited credit support agreement. Front Porch will execute an amended and restated loan agreement and regulatory agreement, and a supplemental indenture with the Authority relating to each series of bonds. The bonds will become an obligation of the Front Porch obligated group, which currently comprises 87% of the total net assets of Front Porch.

Cal-Mortgage has agreed to continue its bond insurance coverage of this debt.

FINANCIAL DISCUSSION:

Although Front Porch is highly leveraged, earnings have produced an adequate debt service coverage ratio (for both the Sunny View and the existing Front Porch long-term debt) and liquidity for the three years of our review. Operating profitability has improved as expenses have been kept in check.

Non-operating net revenue has fluctuated dramatically. Front Porch experienced a non-operating loss in fiscal 2003 in excess of \$8 million, largely due to realized losses on sales of securities, and a non-operating gain of nearly \$14 million in 2004, largely due to unrealized securities gains of nearly \$12 million.

Sunny View, which has been directly responsible for the payment of its Authority debt, has been in compliance with its debt service coverage covenant requirements.

See attached financials for Front Porch and Affiliates and for the Front Porch obligated group.

FRONT PORCH:

Front Porch is a system of non-profit communities that serve individuals and families through retirement and affordable housing communities, skilled nursing centers, and related senior and human services.

Front Porch consists of 11 full-service retirement communities that serve 3,000 people in California, and two active adult living communities, serving 340 seniors in Louisiana and Florida. Front Porch was formed in 1999 through the merger of California Lutheran Homes and Community Services, Pacific Homes Corporation and FACT Retirement Services. Each continues to maintain their separate identities and histories through their respective foundations.

Front Porch's affiliates are Sunny View Lutheran Home, consisting of a continuing care retirement community and an affordable housing community for seniors located in Cupertino, and CARING Housing Ministries which provides management and consulting services for 36 affordable housing communities in California and Arizona.

RELIGIOUS AFFILIATION DUE DILIGENCE: Staff has reviewed the Applicant's responses to the questions contained in the Religious Affiliation portion of the Application. No information was disclosed in the questionnaire or staff research to question the Applicant's compliance with the provisions of the Authority's Act relating to religion.

LEGAL REVIEW: Staff has reviewed the Applicant's responses to the questions contained in the Legal Status portion of the Application. No information was disclosed to question the financial viability or legal integrity of this applicant.

RECOMMENDATION: Staff recommends the Authority approve Front Porch's assumption of Sunny View's 1997 and 1999 Authority bond obligations, subject to an opinion from bond counsel that the amendments to the various bond documents are authorized under each of such documents and will not cause interest on the bonds to become includable in gross income for federal income tax purposes, a bond rating of at least an "A" rating by a nationally recognized rating agency, and a final Cal-Mortgage Insurance commitment. This approval is also subject to compliance with the bond issuance guidelines, with an policy exception to allow debt service coverage ratios based on the most recent fiscal year rather than maximum annual debt service.

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Front Porch and Affiliates
Statement of Operations (Consolidated)
(in thousands)

	Year Ended March 31,		
	2005	2004	2003
Operating revenue:			
Resident and net patient service revenue	\$ 123,675	\$ 117,904	\$ 113,605
Amortization of accommodation fees	8,620	9,190	8,270
Change in estimated future service obligation	132	616	568
Other	8	52	33
Net assets released from restriction/for operations	439	297	266
Total operating revenue	<u>132,874</u>	<u>128,059</u>	<u>122,742</u>
Operating expenses:			
Medical services	27,947	26,715	30,081
Facility operating costs	15,143	14,624	13,665
Dietary services	20,620	19,819	18,140
Residential services	10,731	10,281	9,544
Administrative services	28,185	27,048	23,664
Depreciation	14,586	14,735	14,076
Amortization of deferred costs	560	566	552
Interest expense	10,404	11,459	11,116
Other	3,029	2,639	2,701
Total operating expenses	<u>131,205</u>	<u>127,886</u>	<u>123,539</u>
Operating gains/losses	1,669	173	(797)
Nonoperating revenue, net:			
Contributions and gifts income	128	38	224
Investment income (loss)	994	13,789	(9,624)
Nonoperating gains (losses)	9	(7)	1,163
Total nonoperating revenue, net	<u>1,131</u>	<u>13,820</u>	<u>(8,237)</u>
Excess of revenue over expenses	<u>2,800</u>	<u>13,993</u>	<u>(9,034)</u>
Discontinued operations	354	(634)	-
Net assets released from restriction for capital expenditures	419	175	518
Net assets assumed in affiliation with Sunny View	-	-	4,953
Increase in unrestricted net assets	<u>3,573</u>	<u>13,534</u>	<u>(3,563)</u>
Unrestricted net assets, beginning of year	<u>46,881</u>	<u>33,347</u>	<u>36,910</u>
Unrestricted net assets, end of year	<u>\$ 50,454</u>	<u>\$ 46,881</u>	<u>\$ 33,347</u>

Front Porch and Affiliates
Statement of Financial Position (Consolidated)
(in thousands)

	As of March 31,		
	2005	2004	2003
Assets:			
Current Assets			
Cash and cash equivalents	\$ 13,442	\$ 16,878	\$ 11,210
Short-term investments	637	427	1,420
Limited/restricted assets	11,683	10,975	10,042
Accounts receivable, net	4,808	5,157	5,716
Prepaid expenses	1,666	1,775	1,647
Total current assets	<u>32,236</u>	<u>35,212</u>	<u>30,035</u>
Investments	75,372	60,420	41,245
Assets- limited, board designated	1,335	1,335	1,335
Assets - limited/restricted, net	47,785	48,404	48,670
Derivative financial instruments	1,599	1,919	1,456
Interest in net assets of Pacific Homes	6,325	6,160	5,391
Receivable from CLH and Fact Foundation	6,115	6,139	5,214
Deferred costs, net	7,567	6,936	7,502
Property and equipment, net	203,060	207,264	213,967
Total assets	<u>\$ 381,394</u>	<u>\$ 373,789</u>	<u>\$ 354,815</u>
Liabilities and Net Assets:			
Current Liabilities			
Current portion of long-term debt	\$ 4,189	\$ 3,945	\$ 3,907
Accounts payable	3,510	4,479	4,555
Accrued payroll and related expenses	9,312	7,797	5,408
Accrued interest	5,387	5,460	5,543
Other accrued expenses	2,510	2,040	2,010
Total current liabilities	<u>24,908</u>	<u>23,721</u>	<u>21,423</u>
Other accrued liabilities	10,269	9,492	9,362
Derivative financial instruments	25,838	22,303	20,657
Deferred interest - forward sales agreements	7,124	4,135	1,548
Deferred revenue from accommodation fees	46,330	46,892	45,962
Long-term debt	203,254 *	207,281	211,226
Total liabilities	<u>317,723</u>	<u>313,824</u>	<u>310,178</u>
Net assets:			
Unrestricted	50,454	46,881	33,347
Temporarily restricted	10,017	10,003	8,462
Permanently restricted	3,200	3,081	2,828
Total net assets	<u>63,671</u>	<u>59,965</u>	<u>44,637</u>
Total liabilities and net assets	<u>\$ 381,394</u>	<u>\$ 373,789</u>	<u>\$ 354,815</u>

* Long-term debt includes \$199,113,000 in non-Authority debt.

Financial Ratios:

Debt Service Coverage (x)	1.96	2.58	1.44
Debt/Unrestricted Net Assets (x)	4.11	4.51	6.45
Margin (%)	1.3%	0.1%	-0.6%
Current Ratio (x)	1.29	1.48	1.40

Front Porch (obligated group)
Statement of Operations
(in thousands)

	Year Ended March 31,		
	2005	2004	2003
Operating revenue:			
Resident and net patient service revenue	\$ 112,313	\$ 107,293	\$ 105,783
Amortization of accommodation fees	7,424	8,189	8,067
Change in estimated future service obligation	132	616	568
Other	68	81	69
Net assets released from restriction/for operations	380	258	241
Total operating revenue	<u>120,317</u>	<u>116,437</u>	<u>114,728</u>
Operating expenses:			
Medical services	25,238	24,387	26,253
Facility operating costs	13,737	13,413	12,980
Dietary services	19,241	18,623	17,861
Residential services	9,681	9,356	9,315
Administrative services	24,890	23,153	21,323
Depreciation	13,790	13,938	13,744
Amortization of deferred costs	537	541	542
Interest expense	9,758	10,761	10,930
Other	2,546	2,139	2,421
Total operating expenses	<u>119,418</u>	<u>116,311</u>	<u>115,369</u>
Operating gains/losses	899	126	(641)
Nonoperating revenue, net:			
Contributions and gifts income	-	4	205
Investment income (loss)	831	13,105	(9,411)
Nonoperating gains (losses)	9	(7)	1,163
Total nonoperating revenue, net	<u>840</u>	<u>13,102</u>	<u>(8,043)</u>
Excess of revenue over expenses	<u>1,739</u>	<u>13,228</u>	<u>(8,684)</u>
Discontinued operations	354	(378)	-
Net assets released from restriction for capital expenditures	376	169	518
Net assets assumed in affiliation with Sunny View	-	-	4,953
Increase in unrestricted net assets	2,469	13,019	(3,213)
Unrestricted net assets, beginning of year	<u>40,976</u> *	<u>28,352</u> *	<u>32,365</u>
Unrestricted net assets, end of year	<u>\$ 43,445</u>	<u>\$ 41,371</u>	<u>\$ 29,152</u>

* Prior year adjustments of \$800 and \$395 were made in 2004 and 2005 respectively.

Front Porch (Obligated Group)
Statement of Financial Position
(in thousands)

	As of March 31,		
	2005	2004	2003
Assets:			
Current Assets			
Cash and cash equivalents	\$ 12,339	\$ 14,786	\$ 10,066
Short-term investments	637	405	1,395
Limited/restricted assets	11,385	10,697	9,859
Accounts receivable, net	4,366	4,329	4,441
Prepaid expenses	1,489	1,618	1,084
Intercompany receivables	217	1,045	3,285
Total current assets	30,433	32,880	30,130
Investments	71,490	59,106	40,231
Assets- limited, board designated	-	-	-
Assets - limited/restricted, net	44,702	45,220	46,081
Derivative financial instruments	1,599	1,919	1,456
Interest in net assets of Pacific Homes Foundation	6,325	6,160	5,391
Receivable from CLH and Fact Foundation	6,115	6,139	5,214
Deferred costs, net	7,341	6,687	7,229
Property and equipment, net	188,862	192,941	197,619
Total assets	\$ 356,867	\$ 351,052	\$ 333,351
 Liabilities and Net Assets:			
Current Liabilities			
Current portion of long-term debt	\$ 3,756	\$ 3,534	\$ 3,510
Accounts payable	3,218	4,207	4,114
Accrued payroll and related expenses	8,335	7,196	4,916
Intercompany payables	-	-	-
Accrued interest	5,263	5,335	5,403
Other accrued expenses	2,276	1,844	1,713
Total current liabilities	22,848	22,116	19,656
Other accrued liabilities	10,102	9,168	8,769
Derivative financial instruments	25,838	22,303	20,657
Deferred interest - forward sales agreements	7,124	4,135	1,548
Deferred revenue from accommodation fees	42,234	43,130	42,780
Long-term debt	193,029	196,623	200,157
Total liabilities	301,175	297,475	293,567
 Net assets:			
Unrestricted	43,445	41,371	29,152
Temporarily restricted	9,047	9,125	7,804
Permanently restricted	3,200	3,081	2,828
Total net assets	55,692	53,577	39,784
Total liabilities and net assets	\$ 356,867	\$ 351,052	\$ 333,351